ST 00-21
Tax Type: Sales Tax
Issue: Responsible Corporate Officer – Failure to File or Pay Tax

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No.**
	NPL #
v.	**IBT #**
JANE DOE, as Responsible Officer of DOE'S WORLD, Inc.	**Kenneth J. Galvin Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Christopher M. Saternus, on behalf of JANE DOE, Mr. Marc Muchin on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to JANE DOE's (hereinafter "DOE") protest of Notice of Penalty Liability No. XXXX (hereinafter the "NPL") as responsible officer of DOE'S WORLD, Inc. (hereinafter "DOE'S WORLD"). The NPL consists of two assessments; the first covering the period from July of 1989 through December of 1991 and the second covering the period from September through October of 1990. A hearing was held in this matter on July 12, 2000. Following submission of all evidence and a review of the record, it is recommended that NPL No. XXXXX be finalized through August 15, 1991, for assessment XXXXX and finalized as

issued for assessment XXXXX. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No. XXXX, issued January 10, 1995, consisting of assessment number XXXXX in the amount of $213,075.10 including interest calculated through the date of issuance, for the months of July, 1989, through December, 1991 and assessment number XXXXX in the amount of $86.58, including interest calculated through the date of issuance, for the months of September through October, 1990. Dept. Ex. No. 1.
2. JOE BLOW ("BLOW") was the owner and vice president of BLOW'S EXPRESS ("BE"), a local trucking company. On August 15, 1991, BLOW signed an "Asset Purchase Agreement" (the "Agreement") with DOE and DOE'S WORLD for the purchase of all personal property used in the operation of DOE'S WORLD including forklifts, trucks, trailers, all files used in the business and the trade name "DOE'S WORLD." Tr. pp. 13-15; Taxpayer's Ex. No. 1.
3. Paragraph 2 of the Agreement states that "[P]urchasers will not assume any liabilities of DOE'S WORLD." Paragraph 9(e) states that DOE'S WORLD "is and will remain responsible for and pay all federal, state and local taxes including, but not limited to, all income, earnings, withholdings, employment and property taxes" prior to the closing date. Tr. pp. 11-16, 84; Taxpayer's Ex. No. 1.
4. Paragraph 9(b) of the Agreement states that "DOE'S WORLD shall deliver prior to or at the closing, all items, books, records, files, agreements, purchase orders, internal reports, and materials in [DOE'S WORLD's] possession related to the transaction contemplated by the

terms of this agreement. Purchasers agree to preserve all such delivered items for 7 years after the closing date…" Tr. pp. 16-17; Taxpayer's Ex. No. 1.

5. Within a week after the closing, BLOW sent two trailers to DOE'S WORLD and emptied the offices, including pallets, desks, file cabinets, records, and personal items. Some of the items removed from DOE'S WORLD were kept at the offices of BE. DOE was not notified and was not present when the offices were emptied. Tr. pp. 17, 25-28, 34, 36-37, 87, 124-126.
6. The basement of BE had three floods. In June of 1992, BE incurred a repair charge for a break in the water line of $268. This $268 represented BE's portion of a total repair bill shared with 18 other property owners. Some records were destroyed in the floods. Tr. pp. 18-19, 28-29; Taxpayer's Ex. No. 2.
7. JIM BOB, Certified Public Accountant, was employed by XYZ Accountants beginning in February, 1990. XYZ prepared corporate tax returns, sales tax returns, and compiled financial statements for DOE'S WORLD. Tr. pp. 38-41, 46-47.
8. XYZ would receive a worksheet and backup data from DOE'S WORLD stating the nature of the sales for the month including whether there was repair work on the pallets, wholesale sales and resale sales. XYZ kept signed checks from DOE'S WORLD's tax account. After XYZ completed the sales tax returns, they would fill in the payment amount on a signed check, remit it to the Department of Revenue and advise DOE of the amount. XYZ would then send that month's information, including ledgers, journals, check stubs, cancelled checks back to DOE, and DOE filed the data by month and year in a cabinet. Tr. pp. 41-44, 87-88, 126-127; Taxpayer's Ex. No. 3.
9. DOE's father founded DOE'S WORLD. DOE bought the company from his stepmother in 1989. DOE borrowed $50,000 from Aetna Bank for start up capital, and as security for the loan,

Aetna put liens on the equipment. DOE's stepmother explained to him how she kept the books and records and how she reported monthly sales figures to XYZ Accountants. Tr. pp. 76-78.

10. DOE was president of DOE'S WORLD at a salary of $900 per week. He was responsible for hiring and firing employees and he signed checks. A secretary gathered the sales figures for the month and submitted them to DOE for approval. Some sales tax returns were signed by DOE. Dave JIM BOB had authority to sign and did sign DOE's name on some sales tax returns. DOE determined the order of debt payment. Tr. pp. 114-121; Taxpayer's Ex. No. 3.
11. Richard Lipschultz, Attorney, represented DOE'S WORLD in connection with the Asset Purchase Agreement, an Employment Agreement and a Consulting Agreement, all with BE. Under the Consulting Agreement, DOE was to receive 7% of all business done with DOE'S WORLD's former customers for a three-year period. The Agreement was structured so that these payments were made monthly to Aetna Bank to pay off the $50,000 loan for start up costs. The full amount of the loan was eventually paid. Tr. pp. 56-62, 85, 102; Taxpayer's Ex. Nos. 1, 3.
12. DOE also signed an Employment Agreement with BE at a salary of $700/week for a three-year period. He worked as a forklift driver and inventory taker for BE until April of 1995, when BE was sold. Tr. pp. 19, 86, 103-104; Taxpayer's Ex. No. 1
13. In November of 1992, DOE was contacted by a Department auditor, who advised him that she was going to need books, records and ledgers for an audit. Tr. p. 95.
14. DOE went to BE's office to retrieve DOE'S WORLD's records. BLOW took DOE down to the basement but there were no records for DOE'S WORLD. Tr. pp. 95-96.
15. DOE then contacted JIM BOB at XYZ Accountants and requested DOE'S WORLD's records. JIM BOB advised DOE that XYZ wanted DOE to pay his past due bill of $3,500 before records

would be released. XYZ wanted an immediate payment of $800 and a promissory note for the balance. Tr. pp. 97-99.

16. XYZ later gave DOE their own working papers for DOE'S WORLD, which DOE gave to the Department auditor. The auditor said that she needed DOE'S WORLD's original books and records and that XYZ's information was not sufficient for her to do the audit. Tr. pp. 100-101, 133-135.

17. Notice of Tax Liability No. XXXXX, dated June 8, 1993, for the audit period July 1, 1989 to December 31, 1991 was first sent to DOE'S WORLD by certified mail on June 8, 1993. It was returned from the post office marked "forwarding address expired." The Notice was then sent to DOE'S WORLD, c/o Marlon DOE, 148 Sunset Lane, Bolingbrook, Illinois. This was returned as "unclaimed." Tr. pp. 110-114; Taxpayer's Ex. Nos. 5, 6.

Conclusions of Law:

The sole issue to be decided in this case is whether DOE should be held personally liable for the unpaid retailers' occupation tax of DOE'S WORLD. The statutory basis upon which any personal liability is premised is Section 13½ of the Retailers' Occupation Tax Act, which provides in relevant part:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment *** and who willfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon; The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty under this Section.

Ill. Rev. Stat., ch. 120, par. 452½ (1987).

It is clear under Section 13½ that personal liability will be imposed only upon a person who: (1) is "responsible" for filing corporate tax returns and/or making the tax payments; and (2) "willfully" fails to file and/or pay such taxes.[1]

The admission into evidence of the NPL establishes the Department's *prima facie* case with regard to both the fact that DOE was a "responsible" officer and the fact that he "willfully" failed to file and or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a prima facie case, the burden shifts to the taxpayer to overcome the case. Masini v. Department of Revenue, 60 Ill.App.3d 11 (1st Dist. 1978).

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursal of funds. Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id*.

I have concluded, based on the testimony and evidence admitted at the evidentiary hearing, that DOE was a responsible party under the statute prior to the sale of DOE'S WORLD to BE on August 15, 1991. DOE was president of DOE'S WORLD. Tr. p. 114. DOE hired and filed DOE'S

[1] Prior to January 1, 1994, Section 13½ of the Retailers' Occupation Tax Act governed the assessment of personal tax penalties against responsible corporate officers or employees. However effective January 1, 1994, the penalty provision of Section 13½ was replaced by Section 3-7 of the Uniform Penalty and Interest Act (35 ILCS 735/3-7).

Here the taxes accrued between 1989 and 1991, while Section 13½ was in effect. On the other hand, the NPL was not issued until 1995. Thus, a question arises as to whether Section 13½ or Section 3-7 controls the case at hand. In Sweis v. Sweet, 269 Ill.App.3d 1, 12 (1995), it was held that the penalty provision "in effect at the time the tax was incurred" should be applied. In accordance with this holding, I conclude that Section 13½ is controlling.

WORLD's employees and determined their salaries. Tr. p. 114. DOE signed checks and he approved the information sent to the accountants for the preparation of the sales tax returns. Tr. pp. 115-116. Some sales tax returns were signed by DOE, but JIM BOB had authority to sign and did sign DOE's name on other sales tax returns. Tr. pp. 116-119. DOE also determined the order of debt payment. Tr. p. 121. The evidence shows, therefore, that up until the sale of DOE'S WORLD on August 15, 1991, DOE was a responsible party who had the control, supervision and responsibility for filing tax returns and making payments.

I have also concluded that DOE's responsibility for the filing of tax returns and the payment of taxes ended on August 15, 1991 when the Asset Purchase Agreement and Employment Agreement were signed with BLOW. The Employment Agreement was for a "period of three years commencing as of August 16, 1991. Under this Agreement, DOE was a "working employee with managerial responsibilities," described as follows:

> Employee shall render the services customarily rendered by an employee serving in such capacity including consulting with and advising the officers of Chicago Suburban Pallet Service (CSPS) upon matters incident to the business of CSPS at such reasonable times as CSPS may request. Such consultations are intended to include, but not be limited to, technical advice and recommendations in connection with production processes. All such consulting work shall be in addition to Employee's assigned working job.
> Taxpayer's Ex. No. 1, Employment Agreement, sec. 2(a)(b).

DOE testified that it took him 45 days to negotiate the Asset Purchase Agreement and Employment Agreement because he was arguing with BLOW over whether BLOW would hire DOE'S WORLD's existing employees. Tr. p. 101. DOE testified that 28 days after their hiring by BE, the DOE'S WORLD employees "were all let go before their insurance and all took effect. The basis for that was they were making a lot more money than the employees at the current pallet company." Tr. p. 102. DOE then described his own duties as follows:

> In the beginning in the first month or so I was working with my men getting them to get into the routine and the procedures that the new pallet company had that they had in place. After my men were all let go I was instructed that they were going to make me the manager of inventory out in the big storage yard that we had across the street which consisted of five acres of blacktop that we stored about 100 something thousand pallets out on. So my daily job description was basically a forklift driver and an inventory taker. … I had one gentleman that worked with me out in the yard that basically what we did all day was pallets. As they would come out of the dock area into the repair tables and dropped in the yard we were in charge of putting them away.
> Tr. pp. 103-104.

BLOW testified that DOE "first started in operations, and then I felt that his talents would be better served in sales, and then he was in sales." Tr. p. 19. DOE never mentioned in his testimony that he was in "sales." There was no testimony from either DOE or BLOW that DOE had responsibility for the payment of taxes or the filing of tax returns after August 15, 1991. It is noted that it is unlikely that an employee in a "sales" or "operations" position would be responsible for the payment of taxes and the filing of tax returns. Based on the provisions of the Employment Agreement and the testimony presented at the evidentiary hearing, I must conclude that DOE was not a responsible officer of DOE'S WORLD after August 15, 1991.

The second element which must be met in order to impose personal liability is the willful failure to pay taxes. The Department presents a prima facie case for willfulness with the introduction of the NPL into evidence. Branson, *supra*. The burden then is on the responsible party to rebut the presumption of willfulness.

DOE attempted to rebut the presumption of willfulness by testifying that DOE'S WORLD's sales tax records were lost in floods after the purchase of DOE'S WORLD by BLOW. According to DOE's counsel, "… the books and records weren't there. That doesn't make him

unwilling to pay the tax. It doesn't make him willful for the non-payment of tax or the filing of returns. It makes him the victim of an accident." Tr. p. 148.

I am unable to conclude, based on the testimony presented at the hearing, that DOE was "the victim of an accident." BLOW repeatedly testified that he did not "remember exactly what particular records" were taken from DOE'S WORLD. Tr. p. 25. BLOW was asked, "So the property that you took from [DOE'S WORLD] to wherever on your premises you don't really know what that consisted of ?" He responded: "No, not paper for paper. I can't remember." Tr. p. 28. Additionally, Richard Lipschultz, attorney for DOE'S WORLD in connection with the Asset Purchase Agreement, testified that he did not have personal knowledge of whether DOE'S WORLD turned over its records to BLOW:

> I do remember when we had the closing at the purchaser's attorney's office, I do remember one or two or three banker's boxes – the long kind of banker's boxes that tie at the end – being moved around. I don't know that I ever actually saw what was in those boxes, but they may have been some of the records of DOE'S WORLD.
> Tr. p. 64.

Not only am I unable to conclude that DOE turned the sales tax records over to BLOW, but I am also unable to conclude that the records were destroyed in a flood. BLOW could not pinpoint the dates of the flood: "I remember a flood. If I remember the exact date, I can't remember." Tr. p. 29. BLOW presented a "Water Invoice," for the period of May 25, 1992, through June 24, 1992, showing a charge for "repair" of $268. Taxpayer's Ex. No. 2. Although this "repair" predates DOE's first contact with the Department auditor in November of 1992, I cannot conclude, based on this "Water Invoice" alone, that DOE'S WORLD's records were destroyed in a flood.

Indeed, BLOW did not remember DOE even asking for the records:

> Q: Do you recall a period of time after the closing of the business where Mr. DOE approached you and asked

you for copies of the records?
A: I don't really recall.
Tr. pp. 17-18.

It must also be noted that DOE did retrieve some records from BLOW: "[BLOW] let me go down there and get, you know, what personal stuff I had out of my desk. He told me he would get me my desk over to the pallet company as soon as he could. I took my wife's pictures on my desk and whatever personal stuff. I think I even took a picture that my sister gave me for Christmas that I had hanging in my office." Tr. p. 128. DOE was then asked:

Q: Did you think to take possession of your file cabinets?
A: No.
Q: You could have?
A: They weren't even in the same area.
Tr. p. 128.

In order to overcome the Department's *prima facie* case, evidence must be presented which is consistent, probable and identified with the corporation's book and records. Central Furniture Mart Inc. v. Johnson, 157 Ill.App.3d 907 (1st Dist. 1987). Although DOE testified that he turned over DOE'S WORLD's records to BLOW, and these records were destroyed in a flood, the testimony is neither supported by documentary evidence not corroborated by other witnesses. Although the statute does not define what constitutes a willful failure to pay taxes, the Illinois Supreme Court accepts as an indicia of willfulness, a showing of "reckless disregard for obvious risks." Department of Revenue v. Heartland Investments, 106 Ill.2d 19, 29 (1985). According to DOE, he signed an agreement to turn over DOE'S WORLD's records to BLOW, he was aware that the records were kept in a basement, he did not retrieve the records although he was clearly able to do so and had retrieved personal items. His behavior presented an obvious risk that the records would not be available if needed. DOE chose to recklessly disregard this risk and that is sufficient to find willfulness under the statute.

WHEREFORE, for the reasons stated above, it is my recommendation that NPL No. XXXX be finalized through August 15, 1991 for assessment XXXXX and finalized as issued for assessment XXXXX.

ENTER:

August 21, 2000

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Kenneth J. Galvin
Administrative Law Judge